RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

P. O. Box 1759, La Jolla, California 92038
Minimum of 26 Letters per year – $185 Annually
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December 31. 1980 **LETTER 799**

Dec. 19, DJIA 937.20; PTI 1358; A-D Ratio –18.49
Dec. 26, DJIA 966.38; PTI 1376; A-D Ratio –17.62

THE MARKET: In the last Letter I pointed out a number of Averages and indices that were not confirming on the downside during the sharp November-December sell-off, but the picture is a bit clearer now.

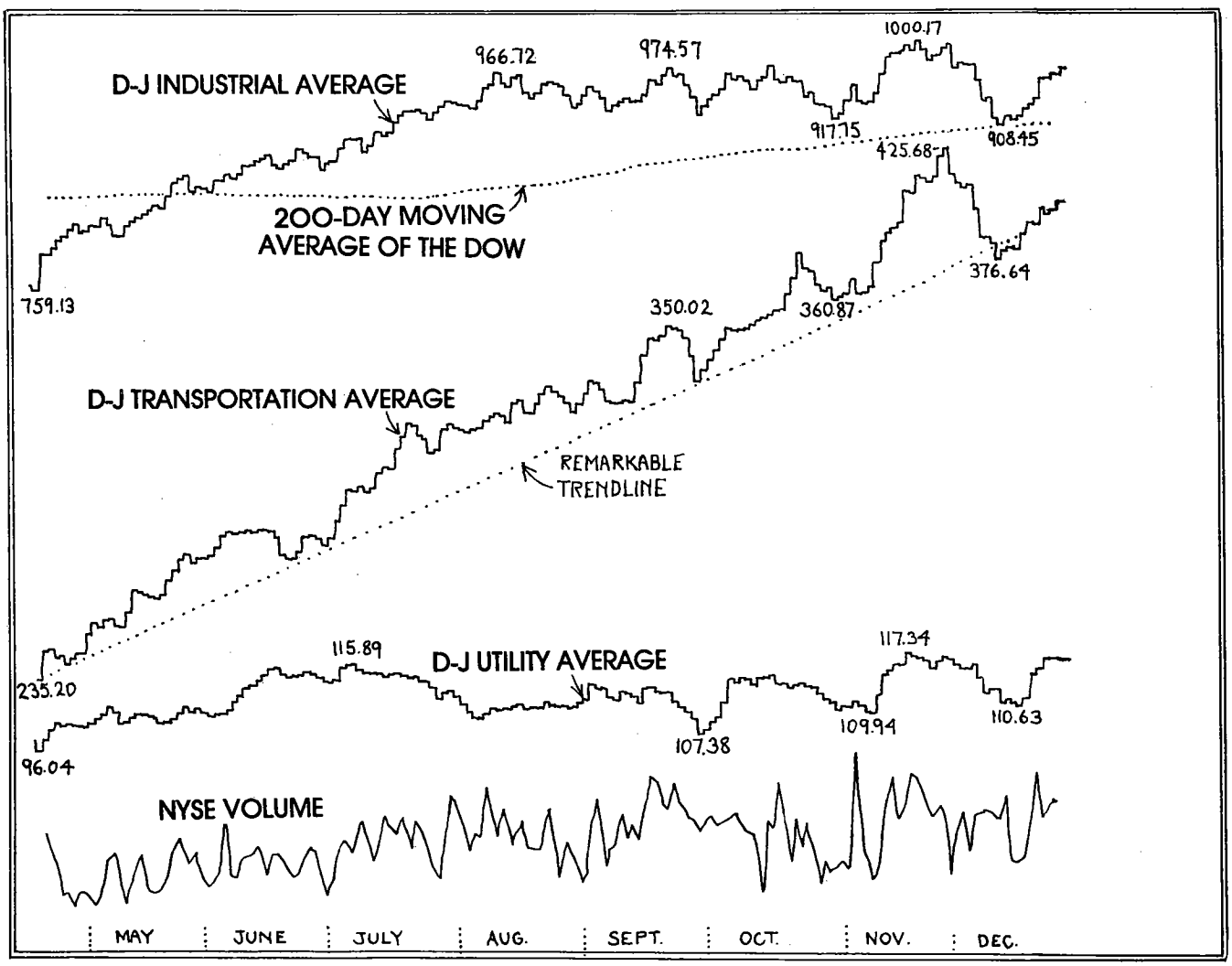
Study the chart of the Averages below. From their November highs, the Averages turned down. The violent decline carried into December. On December 11 the D-J Industrial Average closed at a low of 908.45. On the same day the Transports closed at 376.64. A few days later, on December 16, the Utility Average closed at 110.63.

The December 11 Industrial low (and it was the Industrial low which attracted most attention) was slightly more than 9 points below the preceding October low. The Transports, however, did *not confirm*, and the 376.64 Transport low was 16 points *above* its preceding October low. Finally, the Utility low of 110.63 was a fraction above its November 7 low and a full 3 points above its September low. The downside nonconfirmations by two of the three D-J Averages set the stage for an advance. The advance began on December 12.

ENTER (POW) LAUREN: It may not be front page news for you – but it is for me. And if this Letter is a bit disjointed, you'll know why. Lauren Bedford Russell was born on December 21, a whopping 9 pounds 5 ounces – with jaundice. Which wouldn't have been so bad except that mom (Paula) promptly got the flu – shakes and all. If you can picture that combination, you know what controlled chaos is!

Lauren is my fifth child (my fourth girl) and will represent my last major population effort. She's a beauty, and as my mother used to say about me, "I wouldn't take a million dollars for him, and I wouldn't pay a nickel for another one." Actually, I think kids keep you young. They do that by keeping you from being too absorbed in yourself. They also keep you in tune with what's happening in the young world.

I guess I can say that I truly span the generations. I have 'em from 24 years old to 24 hours old. But as they say – enough is enough!



On December 19 it was reported that the short interest on the NYSE rose 6 million to a record 82 million shares sold short. Granted that there is a great amount of "selling against the box" for tax purposes, granted that there is a good deal of short selling against option positions, this is still a whopping number of shares sold short, and it represents a strong plus in the technical picture.

Finally, as noted in the last Letter, the Industrial Average came down to within striking distance of its 200-day moving average but it did *not* penetrate the moving average. This too must be taken as a technical plus.

So from a Dow Theory standpoint, the price structure, although battered, remains very much intact. Neither Transport nor Utilities confirmed the November 11 low in Industrials. In the face of this "refusal to confirm," 82 million short sellers must have felt the edge of panic. The market response was predictable- a sharp advance towards the November highs.

Now turn to the chart of the Dow, The Primary Trend Index (PTI) and the Advance-Decline Ratio. This is beginning to sound like a broken record, but note again that on December 11 and 16, the PTI came down to its rising trendline and then turned up again. I noted this action in the last Letter (page 2) and added, "On December 11 the PTI came down EXACTLY to its rising trendline, the fourth time it has done this since July. On each previous instance, the market reversed and an explosive rally has been set off."

Thus far, although not explosive, the market has acted roughly the way it did during the four previous PTI contacts with the rising trendline. On December 24, in fact, the PTI rose to 1372 or within 9 points of its record high (recorded November 28) of 1381. From the standpoint of the PTI studies I have to conclude that despite all talk and predictions to the contrary, the technical substructure of the market is building up on the plus side-rather than weakening. Certainly a PTI which is continuing to honor its ascending trendline is of little consolation to the short sellers.

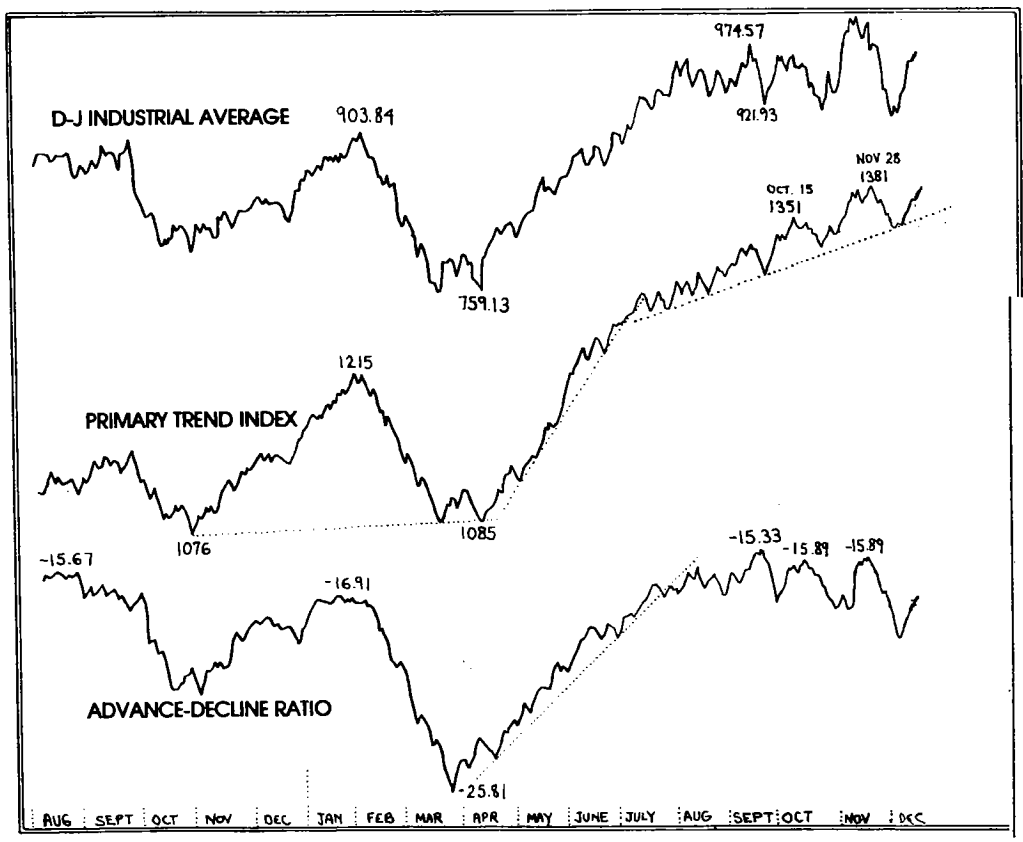
Question: Russell, how much weight do you give to the record short interest now evident on the NYSE?

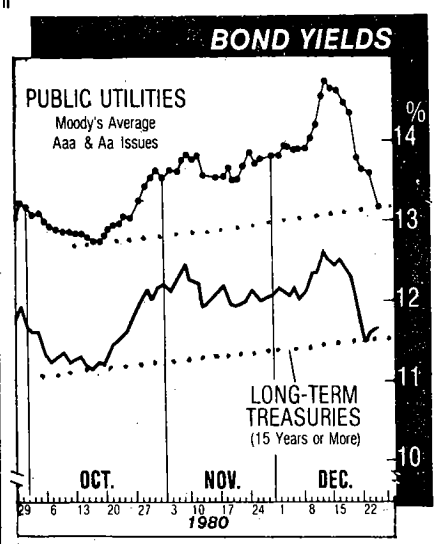
Answer: As far as my data is concerned, a primary bull market is still in progress. A record short interest implies a huge bear contingent which is betting against the continuance of the bull market. For the bears to be correct, the PTI must establish a declining trend and the Averages must break down. This has not occurred. Within that frame work, I therefore consider the huge short interest to be significant and indicative. The technical and psychological conditions are present for an "upside blow-off" on Wall Street – a running of the shorts.

Against this background, I must say that it is most unusual to see the A–D ratio so out of kilter with the Averages and with the PTI. It is clear on the chart that the A–D ratio broke down badly during November. Furthermore, any new high in the Dow (above 1000.17) is likely to find the A–D ratio failing to confirm. In past history, a series of non-confirmations on the part of the A-D has almost always been a forerunner of falling stock prices. For this reason I'm most interested in observing and studying this very rare tug-of-war between the strong PTI and the lagging A-D ratio.

MONEY: I follow a number of money and interest rate indices. Among these are the long-term Government bonds, the Treasury bills, the D-J 20 Bond Average, the Municipal bond indices and my own Russell Bond A-D line.

The number one wish in the Wall Street Book of Wishes is "a top in interest rates." So the question now is, "Do we have that long-looked for top, or is the current rally just a whiff of traders' optimism brought on by thoughts of Christmas and Santa Claus?" Along these lines, expert opinions are a dime a dozen. My own thinking is that this time we're not going to see the big interest rate collapse that has greeted every preceding spike in interest rates. My feeling is that here is too much illiquidity at present, and that there will be ample time during 1981 to buy the interest rate vehicles at present "bargain" prices





or at even greater bargain prices. I know my view differs from most of what you hear today. But I feel it's just too pat to "buy every interest rate spike" and then sit back and let rates collapse as the Fed panics and opens the monetary floodgates again.

OUTER SPACE: There are two bitter facts that must be faced by all Americans. The first is that the finances of the US are "out of control" and spinning off into space like a rocket with no steering mechanism. As I see it, the system has passed the "point of no-return." By that I mean that the cost of servicing the US debt (now approaching $2 billion a week) is threatening to destroy the money markets. With enormous new defense needs, with a Congress that will not apply the ax to Government spending, the choice is clear. That choice is "inflate or die."

Yet we have an Administration that was voted in on a definite anti-inflation ticket. Therefore, it would be unthinkable for the Reagan Administration to continue on the inflation path. But will Reagan (and Congress) chose the path of deflation and depression? It hardly seems likely.

So this is the first bitter fact. It's the fact of inflation (in an effort to carry the debts) or deflation and depression. There's no elasticity in the system no middle ground any more.

The second fact is the absolute necessity of decimating the Federal bureaucracy, slicing it to ribbons. I firmly believe that this nation cannot survive in the form that we know it with the Government continuing to grow like a cancer (which it is). I firmly believe that the country would function well with fully half of all Federal agencies out – closed down. In the 1930's there was 1 Government worker for every 10 in industry. Today there is one Government worker for every 4 in industry. In the first year of the Kennedy Administration the US Government spent $81 billion. Today the budget is $630 billion. This is the road to disaster. And the money markets smell the disaster NOW.

I've thought about this whole problem for years, and I have come to agree with Nobel Prize winner F.A. Hayek. Here is a quote from the American Economics Council's recent interview with Professor Hayek. Read it carefully. It's this or hyper-inflation. I see no other way.

> A: You have no choice now in the United States. Sooner or later you must go through this very unpleasant process of stopping inflation, thereby producing large-scale unemployment and a great deal of suffering and dissatisfaction. The question is merely one of when it will come and how rapidly you can get over it. This is a point on which I, personally, violently disagree with predominant thinking. Many economists, whom I greatly respect, argue that now that you've reached an inflation rate of over 14%, you must reduce it gradually, over a period of years, in order to return to stability. I am convinced this is a political impossibility. The process of returning from an inflationary economy to one with a stable money is so painful that no government can stand the political cost of trying to do it over a five or six-year period. The only chance is to do it radically and immediately — permit no more inflation. Incur all the exceedingly painful consequences — temporary large scale unemployment, numerous bankruptcies — in a period of something like six months and get it over with before opposition can organize sufficiently to force you to stop the process. I think you must have it over in a period of about six months in order to carry through to a successful conclusion. Now no one can tell me this can't be done. American history gives an illustration that it can be done very effectively in even more difficult circumstances. At the beginning of 1919, just after World War I, prices were 60% higher than five years earlier. The Federal Reserve System started on a deliberate policy of deflation, believing that it ought to restore prices to their pre-war level. By the end of six months, the effort had succeeded and the former price level had been restored.

The one thing that Hayek leaves out is the problem of servicing debt during an economic slump. In fact, I read almost nothing anywhere about the almost insurmountable problem of paying off debt during an economic squeeze. Thus, the problem grows larger and larger (as US debt grows larger) and the possibility of managing debt grows more and more impossible as time goes by.

Nevertheless, I am in agreement with Hayek that the US must go "cold turkey" and slam the brakes on inflation. I would add, however, that the US must also slam the brakes on Government spending.

As a final aside, I note with discomfort that Reagan seems to be talking about reducing the *rate* of Government spending, not of cutting the actual level of Government spending. Reducing the upward rate will not do the job. I insist that the only way this country is going to come out of its gathering predicament is to cut deeply into the actual *amount* of Government spending.

NOTES & QUOTES: Preliminary census statistics show an astounding population move to the South and West. Growth rates from the latest census: up 63% in Nevada, 53% in Arizona, 26% in Texas, 41% in Florida. Perhaps symbolically, NY's figures were delayed because of a fire at the records building. Note that three of the four big growth states (Texas, Nevada, Florida) have no state income tax. Also significantly, Texas passed Pennsylvania as the third most populous state. San Diego edged out Baltimore as the nation's eighth largest city.

* *

Reagan cabinet appointments: I like Haig at State, I like Stockman at Budget, I like Weinberger at Defense. About Weinberger, they don't call him "Cap the Knife for nothing." This man is going to cut a lot of fat out of the military, and some of the sluggish action in defense stocks indicates this! As far as Regan for Treasury, I suspect this important appointment is a "bummer." From what I see, Regan is another liberal in Republican garb. After all, what can you say about a guy who contributed to both political parties (which is what Regan did). Maybe he likes bread buttered on both sides.

* *

The full meaning of Jimmy Carter's appallingly weak response to the hostages can now be seen. Fact: Iran needs money and is literally putting the hostages up for $24 billion in ransom. Fact: by breaking into the American Embassy (US territory) Iran committed an act of war. Our response should have been, "Absolutely no deal" and a demand for delivery of the hostages with in 24 hours. After that, take the consequences. As it stands, the net results of the Carter weakness is (1) a chance the hostages will never be released, (2) loss of US prestige, (3) Dead American airmen, lost equipment, a scattering of the hostages.

* *

The Chrysler-union negotiations would be comic if they weren't so tragic. The power-minded union leader (Fraser) is still mumbling about not giving up this or that, but the membership knows that they are actually talking to Chrysler about their jobs, not about cost-of-living boosts. In the end, the whole thing will probably be shoved off as much as possible to the Reagan Administration. The Carter people don't want to go down as the idiots who poured billions of dollars into a sure loser. Yet they don't want to exit with the crash of a major US corporation ringing around their ears.

* *

San Diego not only has fine weather; it has a fine professional football team. The Chargers on December 22 won the AFC Western division, making them the only '79 division champions to win again in 1980. The whole city came out smiling the next day, and I found myself feeling just as happy as everyone else. In days of old, inter-city and feudal "wars" were often settled by jousts in which the best knights squared off against each other. And that, I believe, is the symbolism of professional football today. Would that nations could settle the ego problems of their leaders the same way in these modern times.

* *

The latest *Forbes* (Jan. 5) runs a long list of "Who's Who in the Stock Market" with 5 year price-changes. At the top of the list in 5-year percentage changes are many energy stocks such as *Mitchell Energy, Texas Oil & Gas, Parker Drilling, Murphy Oil, Tosco*; these are all in the top 30. At the bottom of the list (numbers 950 to 1029) are *Ralston, Assoc. Dry Goods, Food Fair, Ford, Fleetwood, K Mart, Great Atlantic and Pacific, Sears, Federated Dept. Stores* (all down 30% or more). My conclusion is that rising energy prices have greatly helped energy producers. But the US middle class is getting squeezed to death and is cutting back, as exemplified by the rotten performance of many leading retail chains.

* *

I believe that the Republicans "blew it" (especially Kemp) when they announced early that they wanted to call a "national economic emergency." They should not have mentioned it until they actually called the emergency on the day Reagan takes office. Now the emergency concept is being debated, kicked around and its impact is lost. Meese has already announced that Reagan won't have anything like "Roosevelt's first 100 days." Carter has come out against the emergency concept, so you know it was a good idea. Speaking of Carter, was there ever a Jimmy Carter? And if so, what happened to him? Put it down as the great disappearing act of the century. My interpretation is that Jimmy's very mad at us because we didn't elect him, so he's punishing us – by evaporating.

* *

From our People Are Different Dept: Japan is unique in that more people die of cerebral hemorrhages there than heart attacks. It is said that because the Japanese are taught not to express their emotions, they literally "blow their tops" ..... Kenya has the dubious distinction of having the world's highest population rate (8 children per woman on average). At this rate, Kenya's population will double every 18 years! ..... Shakespeare wasn't wrong when he talked about the "melancholy Danes." Denmark has the world's highest suicide rate. Incredibly, twice as many Danes die of suicide as in auto accidents!

* *

Notes on Debt: Congratulations Uncle Sam; as of December the Federal debt reached a new record high of $920 billion. If you liked 1980, you're going to love 1981. For the first two months of fiscal 1981 (i.e., October and November) the US Government posted a deficit of $26.3 billion. Annualize this and you get a $157 billion deficit for the year. Of course that won't happen, it will probably be nearer $80 billion for the year. But any way you look at it, the Federal debt is "out of control."

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Henry Kaufman of Salomon Bros. predicts that net US demand for new money will rise to $412 billion, up more than $100 billion from 1980! This is going to keep pressure on the money markets with the probability of new highs in interest rates slated for 1981.

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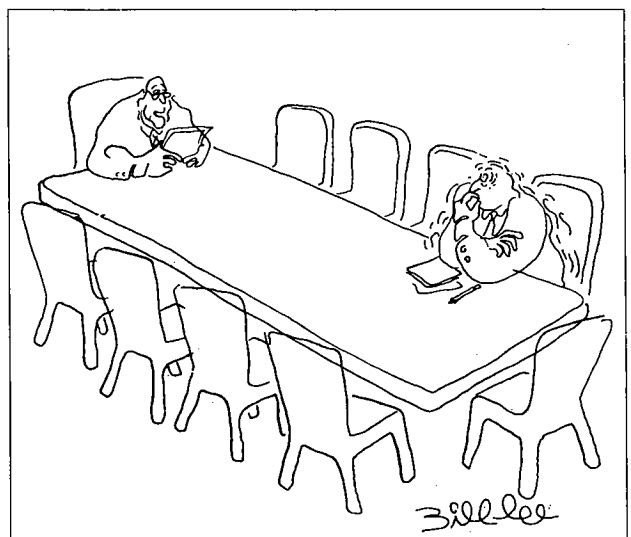
For those with a "smugness problem," here's the 1980 recession cartoon of the year.



"As you all know, this company has felt the discomfort of a mild recession, into which many an American business has fallen. And so, I've gathered you all here together to discuss some additional employment cuts that we must make to ensure the survival of our great organization."

40 PENTHOUSE

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From our "Do You Believe This?" Dept: (Clip courtesy of the Latest *US News and World Report):*

> If Weinberger is serious about rooting out waste and fraud in the Penta-

gon, the Defense Secretary-designate will find no shortage of auditors and investigators to assist him. At last count, there were 18,000 of them already at the Pentagon, which is more than three times as many as in all other federal government agencies put together.

GOLD: Most people don't realize it, but gold has been walking down a descending channel ever since September (see chart). My own feeling is that the December 16 low of 553 (London fix) was a fairly decent low although time may prove that it was only a secondary low.

The seasonal influence comes in now. As a rule gold will make a fairly important low (along with the gold shares) during the fourth quarter of each year. Obviously, 553 was the fourth quarter low for 1980. Therefore, it will be important to see how well gold acts from here. If the action into January and February is weak and unimpressive, then I would say that the concept of dis-inflation or deflation starts to look more meaningful.

Judging by the length of the declining gold channel, I would think that a rising channel (upward correction) should soon be formed. The first sign of this would be a move above the upper channel limits above the 610-615 area.

In the last report I wrote that it will "be important to see whether gold can climb above the 50-week moving average (584) and hold there or whether the 50-week moving average continues to come down." Actually, gold held under the 584 level for only 8 days (Dec. 10 to Dec. 22) and it is now above the 50-week MA or the primary trend line.

Now here is an important item for gold. Gold momentum (13-week rate of change) has been declining ever since January, 1980. But if gold can rise to 650, the declining trend of momentum will turn up for the first time in over a year. The 50-week moving average for gold this week stands at 584. The 13-week MA stands at 617. The 5-week MA is at 597.

CHEERS: Well, that does it for 1980. Technically (and most people don't realize this), the decade ends in 1980 – and the new decade starts in 1981. So here's to the new decade. I have subscribers in every state in the Union and in foreign nations from Israel to South Africa, from the Caymans to Paris. I don't know how to say "Have a fine 1981" in any language but English, but to all my subscribers everywhere, "The best for the new decade. And remember, our true goal is wisdom – not money!"

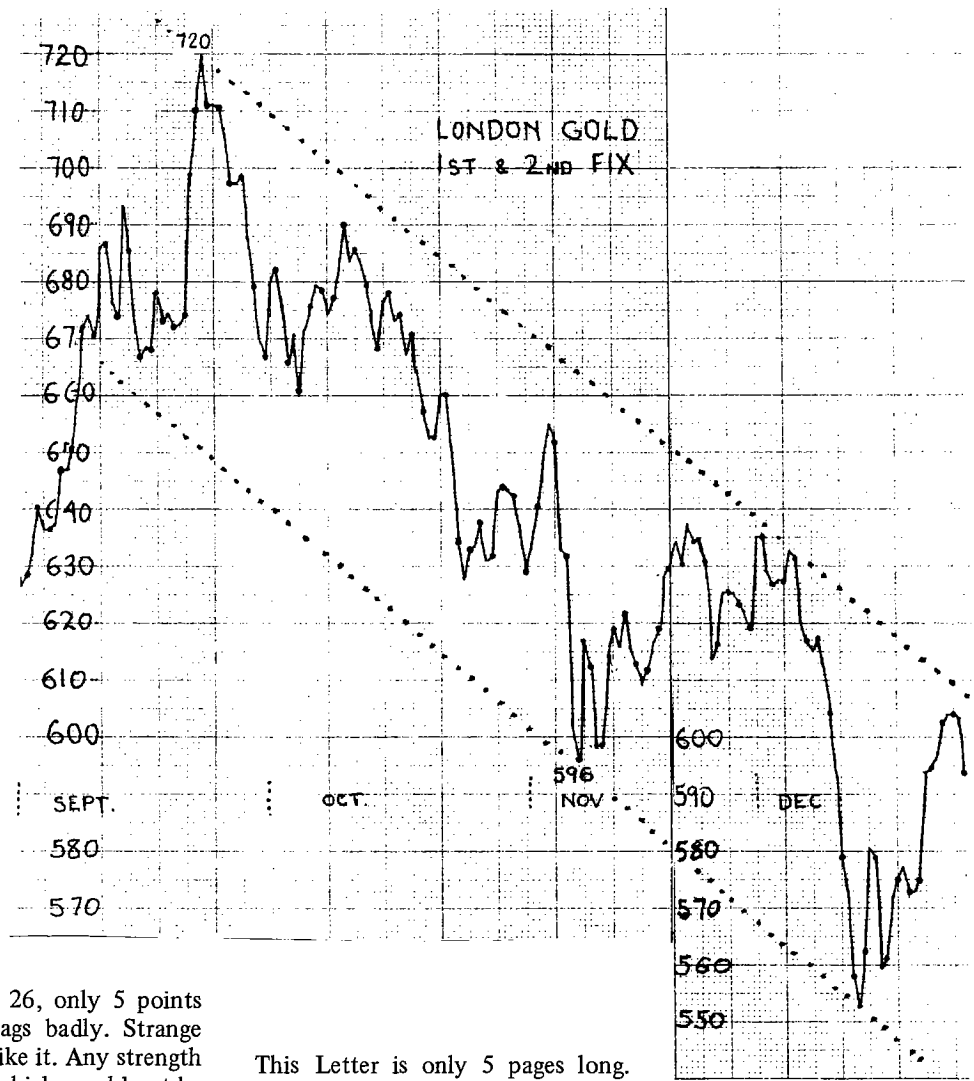
LATE NOTES: The PTI hit 1376 on Dec. 26, only 5 points from the 1381 high! Yet the A-D ratio lags badly. Strange situation, and I've never seen anything quite like it. Any strength this week will send the PTI to a record high which would not be confirmed by the Dow or the A-D.

INVESTMENT POSITION: Most people shovel their money around much the way amateur gamblers do at a Vegas casino: "Let's see, my broker said jump in on Mobil, but I like Penney because it looks cheap. And I guess I'll buy some Treasury bonds because they're rallying." If that's the kind of action you like, you're reading the wrong advisory.

With my own money and that of subscribers, I constantly think in terms of risk/reward. In other words, I think in terms of the best investment with the least risk. I can usually read an advisory and tell after the first few paragraphs whether (1) the advisor has any real money of his own to invest, (2) whether the advisor is a real investor and usually a winner over time or a crap-shooter and invariably a loser over time.

Right now, I feel that the stock market is terribly volatile but still bullish form a technical standpoint. Therefore, the word is "hold" for stocks as it has been ever since the PTI turned bullish last April. But my own inclination is to basically hold high-yielding short-term paper, specifically T-bills for the bulk of my own account. But I've been watching markets for a long time and I've learned to check my "get rich quick" inclinations. As I've said before, I.m a sucker for safe, high yields.

As for gold, I see a trading range of 525-625 for the metal although I have stated that 10% or preferably less of your assests in gold makes sense as a hedge against financial and political disasters.



This Letter is only 5 pages long.
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